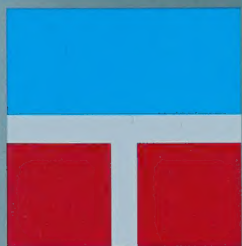


AR71



TESCO
CORPORATION

1999 Annual Report



Vinspear Business Reference
University of Alberta
1-28 Business Building
Edmonton, Alberta T6G 2G6



Innovative Technology with an International Focus

Tesco Corporation is an international oilfield service company operating in over twenty five countries. Tesco designs, manufactures and services highly efficient oilfield equipment that reduces the cost of drilling and producing oil and gas. Tesco is committed to an on-going, in-house research and development program that leads to the practical application of new technology.

ANNUAL MEETING

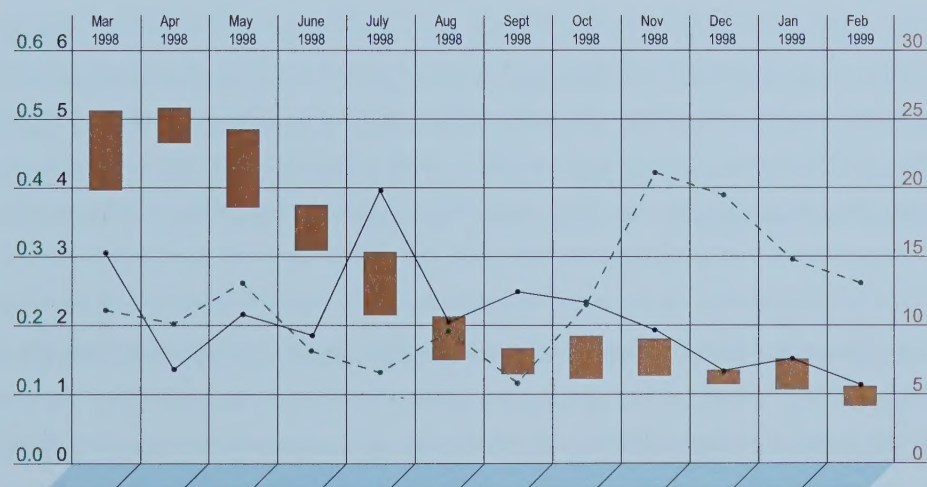
The Annual General Meeting of the Shareholders will be held on Wednesday, July 28, 1999 at 9:00 am in the Fairmount Room of The Blackfoot Inn, 5940 - Blackfoot Trail SE, Calgary, Alberta, Canada.

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Financial Highlights

	1999	1998	1997	1996	1995
For the year ended February 28					
(Millions of Canadian Dollars, except where noted)					
Earnings Information					
Sales	126.1	163.7	95.7	41.9	26.2
EBITDA	7.7	50.3	33.2	16.0	7.8
Net Earnings (Loss)	(2.6)	25.2	16.3	8.7	5.1
EPS (basic – \$ per share)	(0.08)	0.87	0.64	0.43	0.30
EPS (fully diluted – \$ per share)	(0.08)	0.82	0.59	0.37	0.28
Statistical Information					
Top Drive Rental Service Days	13,576	19,547	12,307	7,055	2,371
Top Drive Systems Sold	18	27	14	6	8
Balance Sheet Information					
Capital Additions	42.6	47.8	28.6	19.3	12.1
Working Capital	103.0	84.5	28.4	11.1	6.3
Total Assets	268.3	220.5	109.4	58.1	31.0
Shareholders' Equity	179.5	178.8	87.0	43.6	22.5
Share Information (Millions of Shares)					
Common Shares Outstanding	31.9	31.4	27.3	22.6	16.9
Fully Diluted Shares Outstanding	34.8	34.2	31.1	27.2	19.0

Common Share Performance



- SHARE PRICE – high and low (\$Cdn per share)
- TSE (millions of shares)
- NASDAQ (millions of shares)

To Our Shareholders:

The sharp and unexpectedly rapid decline in world crude oil prices during the fiscal year ended February 28, 1999 created a turbulent environment for the oil and gas industry in North America and around the world. The last twelve months have seen a number of huge combination transactions both of major integrated oil companies and larger worldwide oilfield service companies. These developments profoundly impacted the oilfield service and supply industry and will have long term implications on how service and supply companies must operate to achieve success in the future. For Tesco Corporation, the industry's wrenching changes both validated the strategic direction and underscored the competitive importance of providing customers with a broad array of integrated services and products.

Tesco's corporate objective is to develop and manufacture oilfield products and provide services that improve the efficiency and effectiveness of the world's drilling industry. During fiscal 1999, the Corporation was able to remain focused on this goal and expanded the scope of its operations despite the industry's temporary contraction. The Corporation responded to growing customer demands for a broader range of more efficient services by expanding its product lines and forming alliances with other oilfield service and supply companies. Tesco's new products and services, while continuing to be geared towards generating cost savings for the operator, are also directed towards enabling the operator to enhance the recovery of reserves from older and depleted fields, thus adding value to the reserve base. This is a rapidly growing market as a large proportion of the world's reserves are in depleted reservoirs. This ability to add value has encouraged the Corporation to develop joint venture relationships with customers whereby Tesco shares in the benefits of its products and services. These new ventures should generate significant market share and financial benefits to both the Corporation and its customers.

Tesco's first major product innovation was the portable top drive which, because of its efficiency and cost saving characteristics, gained rapid acceptance in the land drilling industry and represents a major part of the Corporation's business. Today, Tesco has both hydraulic and electric top drives that can be installed within 24 hours on any onshore or offshore rig in the world.

The top drive business became a platform for growth. Building on a strong research and development commitment and proven engineering expertise, Tesco made a major commitment to underbalanced drilling (UBD), an important new drilling technology. By integrating the numerous services associated with UBD, introducing enhancements to equipment and installing automated control systems, Tesco has improved the effectiveness and reduced the cost of the UBD process. UBD has tremendous market potential, particularly in depleted and low pressure formations, which have become a major investment target for oil and gas companies.

During 1999, Tesco expects to commercialize its most significant current development project – Casing Drilling. Casing Drilling has the potential to revolutionize the rotary drilling process by improving wellbore integrity and reducing drilling time through the elimination of drillpipe. The successful commercialization of this technology, combined with existing top drive and UBD operations and other spin-off technologies in downhole tools and well-control equipment, will provide Tesco with a formidable array of products and services with which to assist oil and gas companies in their goals of reducing drilling costs and maximizing reserve values.

FINANCIAL RESULTS

Largely as a result of lower oil prices and the resulting sharp drop in worldwide drilling activity, Tesco sales in fiscal 1999 declined 23% to \$126.1 million from \$163.7 million reported in fiscal 1998. The Corporation recorded a loss for the year of \$2.6 million or \$0.08 per fully-diluted share, compared to net earnings of \$25.2 million or \$0.82 per share in fiscal 1998. The most significant factor in the fiscal 1999 earnings decline was the 31% drop in rental activity for Tesco's top drive fleet, which fell to 13,576 days from 19,547 days in fiscal 1998. However, despite the poor industry environment, rental days remained above the 12,307 registered in fiscal 1997. Tesco sold 18 portable top drive systems in fiscal 1999, compared to 27 in fiscal 1998. The sudden reversal of industry conditions came just after Tesco had committed to a more aggressive top drive production program based on customer demand for rental services. Although the Corporation reacted as conditions shifted, utilization of its growing rental fleet dropped sharply during the year and inventories of parts and equipment grew beyond planned levels, which contributed to the decline in fiscal 1999 earnings. Results in other divisions, including Completions, Electrical and Hydraulics, reflected similar trends.

Two additional factors contributed to lower fiscal 1999 earnings. First, the cost of Tesco's operating and administrative infrastructure was increased substantially early in the year to support the commercialization of UBD and other new products and services as well as development of Casing Drilling, which, prior to fiscal 1999, had been funded by third parties. A second factor was the cost incurred by Tesco to react to the industry downturn in the second half of the year. \$3.1 million has been charged against this year's earnings to restructure the Corporation to allow it to compete effectively in the industry environment of today and tomorrow. Despite the disappointing financial results for fiscal 1999, the Corporation's financial position remains strong. The completion of a US\$46.5 million unsecured note financing will ensure that the Corporation is able to continue to develop and commercialize its new technologies and provides the flexibility needed to pursue new opportunities when they arise.

Responding to changing market conditions, Tesco has taken both short term actions and has developed long term plans to streamline operations by creating a corporate structure that can ensure profitability at low oil and gas prices. The top drive construction program was halted and, despite considerable work in process, the fleet rose by only four units during the year to 111 top drives. A program has been implemented to identify and eliminate surplus inventories. A thorough evaluation of every operation resulted in internal reorganizations of all divisions. Additional cost control measures and head count reductions were implemented throughout the organization and many support services within divisions were consolidated. In addition, the Reservoir Drilling Services Denver office was closed and moved to our existing facility in Houston. By the end of the year, Tesco had completed a 25% overall staff reduction. The effect of these efficiencies will be fully reflected in fiscal 2000.

One of the most important structural actions taken at the end of the year was the reorganization of operations into regionally focussed business units. In addition, product development and manufacturing activities were identified as a separate business unit which is now housed in its own facility. This reorganization will allow operations personnel access to the full range of Tesco products and services enabling them to provide better service to our customers.

OUTLOOK

During fiscal 1999, Tesco maintained its commitment to providing customers with innovative equipment and services that reduce the cost of drilling oil, natural gas and geothermal wells. Despite continuing market uncertainties, this unwavering commitment has positioned the Corporation for continued rapid growth in the years ahead. Tesco has a proven top drive business that should benefit from both a cyclical industry recovery and substantial untapped growth potential worldwide. It has a proven, proprietary underbalanced business with a potential market many times the size of the portable top drive market. Finally, the Corporation is in the late stages of commercializing Casing Drilling, a patentable process, which has a high potential of completely changing the way wells are drilled today.

The combination of our existing and new products and services, with their ability to both reduce the cost of drilling and increase the value of reserves, will be attractive to our customers as the industry begins its recovery. Our organizational structure is in place and cost-effective. We have established relationships with reliable industry partners. Our financial position will allow us to execute our business plan and to respond to new opportunities when they arise.

For this, I wish to recognize the commitment and dedication of our employees, who represent the true measure of Tesco's business success. Our staff performed exceptionally during a particularly challenging year. I also acknowledge the continuing support of our shareholders.

In April 1999, Mark Fischer was appointed Tesco's Chief Operating Officer and Executive Vice President. We believe that Mark's extensive operations, marketing and management experience in the international oilfield services industry will be a valuable asset to the Corporation as it pursues its long term goals.



Robert M. Tessari
President and Chief Executive Officer
May 25, 1999





Review of Operations

CORPORATE REORGANIZATION EFFECTIVE MARCH 1, 1999

In response to changing customer requirements and a broadening corporate mandate to provide a greater range of services, Tesco undertook a thorough review of its organization and cost structure during fiscal 1999. As a result of this review, a new corporate structure was introduced effective March 1, 1999 that will be oriented to regional business units rather than product lines. The Corporation's focus is to provide integrated solutions to customers through enabling technologies that allow operators to produce reserves that would otherwise be uneconomic.

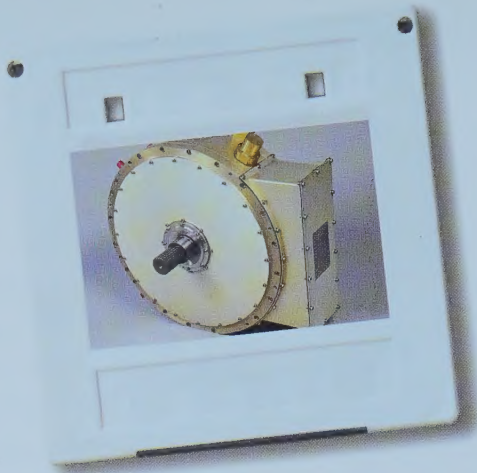
All drilling services (Top Drives and Underbalanced Drilling) have been combined into regional business units which will improve Tesco's ability to market its complete line of services and products to all of its customers. As a result, customers should be able to better understand and utilize Tesco's expanding product lines and technologies. To accomplish this new orientation, the Corporation has established four Drilling Services Business Units: Canada and International, which are based in Calgary, and the United States and Latin America, which are based in Houston. In addition, all Drilling Services product research, development and manufacturing have been centralized in a single business unit. The Product Development Business Unit will incorporate the activities previously undertaken by the Research, Engineering and



Construction division as well as manufacturing operations that were formerly a part of the Top Drive and Underbalanced Drilling divisions. Effective March 1, 1999, the Corporation formed Integrated Services and Solutions (ISS) groups in both Calgary and Houston. These groups will seek opportunities to provide combinations of various services including drilling rigs, top drives, UBD equipment and rotary steerable tools.

Mainline Industries (the Hydraulics Division) and Kelon Electric/Ener-Rig (the Electrical Division) comprise the Industrial Group. Their mandate is to support the Drilling Services Division and increase their third party revenues. Since they have a different external customer base than Drilling Services, both the Industrial Group and the Downhole Tools Division (Gris Gun) will continue to operate independently and will be responsible for their own product development, manufacturing, sales and service.

The restructuring was also an opportunity to streamline business processes and reduce Tesco's cost structure. Changes in facilities' use were made to maximize plant utilization. Manufacturing resources, which were previously split between top drive and underbalanced drilling, now support all divisions, which is expected to increase



productivity and efficiency. In addition, many divisional core services have been centralized which will significantly reduce costs for corporate and support services.

COMMERCIAL PRODUCTS AND SERVICES

Portable Top Drives

Tesco is the world's leader in top drive rentals for land and offshore drilling rigs. Tesco effectively created the rental top drive market with the introduction of its innovative line of compact, highly portable hydraulic top drives and the Corporation designs, manufactures, sells, rents and services portable top drive units throughout the world.

Until the introduction of the top drive, drilling was primarily conducted with the conventional kelly and rotary table system, a technology that had not changed significantly since its introduction in the 1930s. Top drives eliminate the kelly and rotary table, replacing them with a top drive that can move up and down the mast or derrick. Top drives have the unique ability to rotate, hoist and circulate simultaneously, which substantially increases versatility and reduces downhole problems. In addition, connections can be made without picking the bit off the bottom of the hole, a significant improvement over conventional drilling. Drilling can also be conducted with multiple joints of drill pipe. These characteristics make top drives the system of choice for underbalanced, directional and horizontal drilling. The efficiency gains of using top drives are such that nearly all offshore operations use top drives.

Prior to the Tesco portable top drive, the land rig top drive market was limited to only the very largest electric rigs that had the size and power to be fitted with a permanently mounted electric unit. However, the market opened considerably when Tesco introduced a small, portable hydraulic top drive with its own power unit. Because contract drilling companies were reluctant to make the capital investment in the units, Tesco developed the rental market, supplying top drives to operators on an "as needed" basis. Tesco top drives can be temporarily installed and removed in less than 24 hours, allowing operators to pay for top drive services only for the portions of the drilling program where it is cost effective to do so. Over the last five years, Tesco has added still smaller hydraulic units and innovative electric top drives and now produces a broad line of portable top drives that can be installed on virtually any rig operating in the world today, including the service rig market.

Tesco recorded 13,576 top drive rental service days in fiscal 1999, compared to 19,547 days registered in fiscal 1998 and 12,307 days in fiscal 1997. The 31% decline in fiscal 1999 reflected the sharp decline in drilling activity worldwide. However, Tesco was particularly impacted by the near collapse of heavy oil horizontal drilling in Canada, reduced activity in Southeast Asia and a decline in drilling in the U.S. Texas Austin Chalk trend, a major horizontal drilling market

for top drives. Total revenues from top drives in fiscal 1999 were \$88.2 million compared to \$118.4 million in fiscal 1998. The decline in the top drive division's profitability during the year was exacerbated by accelerated maintenance expenses on idle units and the cost of re-deploying 12 units from Canada to international locations.

During fiscal 1999, Tesco built 23 new top drive systems and six top drives that had been sold in Indonesia during fiscal 1998 were repossessed. A total of 18 systems were sold during the year and four units were placed in the rental fleet, increasing the total top drive rental fleet to 111 systems. The remaining units were inventoried pending sale, reflecting Tesco's increased emphasis on top drive sales and the desire to have more units in stock for immediate delivery. With current low rental utilization rates, no additions to the rental fleet are expected for some time. Thus, over the near term, new unit construction will be geared to sales requirements.

Despite the decline in demand for top drives, the top drive division remained active in improving its product offerings. The Corporation upgraded its Hydraulic Miniature (HMI) unit to a 250 ton load rate. The HMI is designed for the very small rig market and service rigs. In addition, a 1,350 ton system was added to the Corporation's relatively new electric top drive line, which utilizes a revolutionary permanent magnet motor. In response to a customer request, one electric unit was configured specifically to meet North Sea certification. The Corporation also rolled out an upgraded hydraulic compact top drive system with an integrated swivel.

The portable land rig top drive market remains largely untapped and the outlook for growth remains excellent. As of early 1999, only 11% of the world's available land rigs were fitted with top drives, 40% of which were supplied by Tesco.

Underbalanced Drilling

During fiscal 1999, Tesco began commercial operation of its integrated underbalanced drilling systems. Underbalanced drilling is a technique that keeps the bottom hole pressure in a well lower than the pressure in the producing formation by reducing the density of the drilling fluid. As a result of the lower hydrostatic pressure in the wellbore, drilling fluids do not enter the formation, thereby eliminating the risk of formation damage. In turn, initial production is usually higher and reservoir recovery is improved. Underbalanced drilling also results in higher rates of drilling penetration, simplified and lower cost completions and reduced incidence of unscheduled events such as differential sticking. Operators can also conduct real-time reservoir investigation. Tesco believes that the market potential by 2005 could reach 10,000 wells worldwide.

Oil and gas flows into the wellbore during the underbalanced process and creates a "controlled blowout" condition that demands coordination and reliable, efficient equipment. Between five and seven service providers have traditionally been required to drill an underbalanced well, resulting in up to 16 workers on site trying to coordinate efforts manually. Tesco's integrated underbalanced drilling system is a





complete closed loop system incorporating improved equipment and programmable logic controllers that automatically adjust to changing bottom hole conditions. Through integration and computerization, Tesco's systems substantially reduce on-site personnel compared to conventional underbalanced operations.

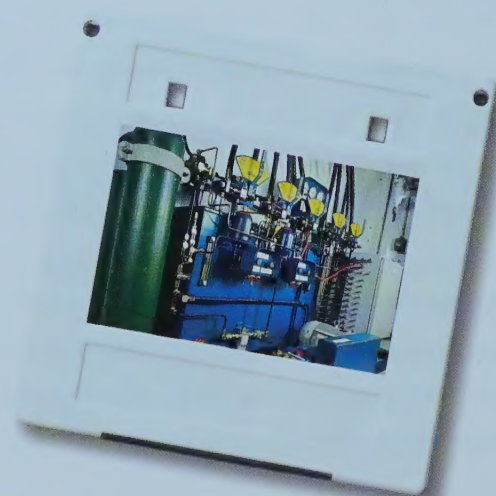
Top drives enhance the efficiency of a UBD system, making this technology a natural extension of Tesco's existing business. It also fits well with the Corporation's business focus on the larger depleted reservoirs around the world that still contain substantial quantities of reserves capable of production.

By the end of fiscal 1999, Tesco had completed the construction of six integrated UBD systems. Five of the systems are mounted on trailers for use in North America and one system is containerized for international use. All of the systems are designed for rapid deployment. Two of the trailer systems were available for work in Canada during the full 1998-1999 winter drilling season and the other three trailer systems commenced work in early 1999. The container system has been shipped to Latin America and one trailer unit system is moving to the Rocky Mountain region of the U.S. Initial industry response to the UBD systems in the field has been excellent. Tesco achieved substantial market penetration in the Canadian winter drilling season and is now considered the industry leader in underbalanced drilling technology.

During fiscal 1999, Tesco entered into a joint operating agreement with Schlumberger of Canada under which Tesco

will be the sole provider of underbalanced drilling services for Schlumberger's Canadian coiled tubing drilling business. One UBD system will be dedicated to this joint venture. Additional units are expected to be dedicated to the partnership during fiscal 2000. The Schlumberger joint venture has considerable potential in Canada and, if successful, could be expanded into other countries.

As part of its integrated and innovative approach to underbalanced drilling, Tesco built five air drilling units, including both air compression and nitrogen generation components, which are being marketed to customers as an allied business independent of the UBD business both in Canada and the U.S. In response to customer demand, Tesco has developed other equipment to complement its UBD systems, including dual annular diverters and push-pull pipe handling machines. These products utilize programmable logic controllers that make them safer and more efficient to operate. During fiscal 1999, Tesco was awarded a contract to provide rotating blowout prevention equipment in Latin America. The Corporation also won an assignment in eastern Canada. Fiscal 1999 was an important year for the UBD division as it entered the commercial phase. However, startup expenses were high and the division reported a loss before tax of \$3.3 million.



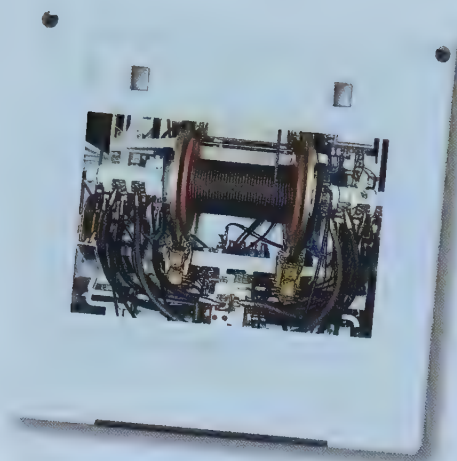
Completions

Tesco's Completions Division (Gris Gun) manufactures and markets expendable perforating guns, charges, tubing conveyed perforating and completion products and other downhole tools. In addition, the division is developing downhole mechanisms for Tesco's Casing Drilling system.

Demand for Gris Gun's perforating guns and charges fell significantly during fiscal 1999, reflecting the sharp decline in well completion activity in Canada. However, the division benefited from an expanded marketing program, which resulted in a substantial increase in international sales. Revenues in fiscal 1999 were \$14.3 million, compared to \$19.9 million in fiscal 1998.

A major focus in fiscal 1999 was to expand Gris Gun's product base. During the year, this division made a successful transition to become a provider of a broader range of downhole products and acquired the exclusive right to manufacture and market a patented electrically actuated hydraulic pulling tool, which has applications in many areas of the completions sector and the Casing Drilling project.

In July 1998, Gris Gun opened its state-of-the-art wellbore research centre adjacent to its manufacturing facility in Red Deer, Alberta. This facility will accelerate the development of proprietary downhole tools and equipment, including tools specifically designed for Casing Drilling. During fiscal 1999, Gris Gun was instrumental in developing new downhole tools and latching devices for the Casing Drilling project. In March 1999, as part of this division's diversification strategy, Tesco acquired the business of Dynamic Oil Tools Inc. Dynamic has developed a number of innovative downhole production enhancement pumps and other products designed for medium and heavy oil applications in Alberta.



Industrial Group

The Industrial Group comprises the Electrical Division (Kelon/Ener-Rig) and the Hydraulics Division (Mainline). These two groups were instrumental in the development of Tesco's line of portable top drives, underbalanced drilling systems, Casing Drilling technology and modular drilling rigs. With these projects now relatively mature, the Industrial Group is focusing on expanding third party business, leveraging its expertise in programmable logic controller and motion control technology not only in the oil and gas industry but other industries such as mining, forestry and power generation.

Total Industrial Group revenues in fiscal 1999 were \$15.3 million compared to \$23.1 million in fiscal 1998. Revenues were unfavorably impacted by a sharp drop in rig construction and drilling activity.

EMERGING PRODUCTS AND SERVICES

Casing Drilling

Casing Drilling, Tesco's most important new technology, is a revolutionary new method for drilling wells that, when commercialized, could lower drilling time by up to 30% and reduce the incidence of unscheduled drilling events.

In conventional drilling, drillpipe must be removed each time a bit or item of downhole equipment is changed. To "trip" or remove and reconnect the drillpipe, is a time consuming process which exposes the open hole to a variety of potential integrity problems. With Casing Drilling, the well is drilled without drillpipe. Instead, the well is drilled with standard oilfield casing which remains in the hole at all times. Drill bits and other downhole tools are lowered via wireline inside the casing and latched to the last joint of casing. Tools are recovered in a similar fashion. Since the casing remains in the well at all times, wellbore integrity is preserved, eliminating most of the problems associated with unscheduled events such as swelling or sloughing formations and washouts. Since drillpipe is not used or tripped, swabbing oil or gas into a well causing a kick or blowout is eliminated, as is wearing a hole in previously set casing. Since the well is cased as it is drilled, unintentional sidetracking and reaming and backreaming are largely eliminated and the risk of tool loss in the hole is reduced.

Since acquiring rights to the technology in 1995, initial funding for the Casing Drilling program was financed through a joint venture. Tesco acquired the joint venture outright in February 1998. During fiscal 1999, the Corporation made a substantial investment in the technology.

Tesco completed the first Casing Drilling vertical test well in December 1998 at Tesco's Research and Engineering Centre in Calgary. The well was drilled to a total depth of 3,040 feet using three casing sizes and encountered coal seams, hard sandstone and shale. Drilling proceeded slowly so that every aspect of the drilling process could be evaluated and encountered, including coring operations. During the test, two of the most important technical aspects of vertical well Casing Drilling were proven: casing connection durability and the wireline latching and unlatching of downhole drilling assemblies. A short interval of the well was drilled with

conventional drillpipe to compare penetration rates to the Casing Drilling process with satisfactory results.

In January 1999, two directional sidetracks were successfully completed on the first well using a directional drilling assembly, including a bent housing mud motor, a measurement while drilling system and an isolation monel drill collar. Deviations of up to 85% were achieved. Drilling of a second multi-directional test well commenced in January to test advanced tools and new casing sizes. In all, six well bores with five casing sizes were drilled. These well bores comprised two vertical, two directional and two out to horizontal. Tesco believes that this is the first time that casing has been successfully directionally drilled with a retrievable bottom hole assembly.

These drilling achievements represented significant project milestones and supported a decision to begin field testing which is expected to commence in June 1999. Tesco is currently in discussions with a number of operators who have inquired about using Casing Drilling to reduce their drilling costs. With the completion of the initial Casing Drilling well tests, the largest R&D outlays have been completed.



Tesco's Casing Drilling success reflects the depth and breadth of the Corporation's technical and operating expertise, as well as the cooperation developed with suppliers and other industry specialists.

Drilling Rigs

During fiscal 1999, the Corporation built and sold two state-of-the-art double hydraulic drilling rigs with Casing Drilling capability to a private western Canadian drilling contractor, Drillers Technology Corp. ("DTC"). These rigs incorporate many new concepts in drilling rig construction, including modular construction that allows for containerization for easier mobilization, computerized control systems, reduced weight, self-elevation and other features developed on the Casing Drilling test rig. A compact single casing rig is also under construction for DTC to be delivered for commercial use in western Canada in June 1999.

On a fully diluted basis Tesco will have a 47% interest in DTC after completion of the third drilling rig. During the 1998/99 winter drilling season, the Tesco-produced drilling rigs performed reliably and profitably in a very competitive market. One of the rigs was used in an integrated service contract which successfully combined the drilling rig with a Tesco UBD system.

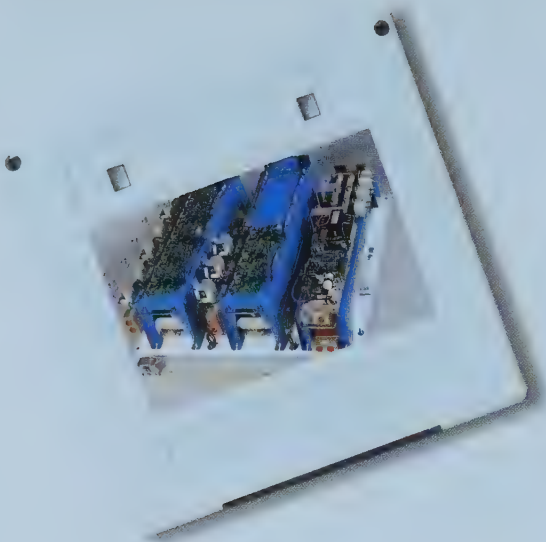
Rotary Steerable Drilling

Directional drilling has become an important tool in the development of oil and gas reserves around the world. However, technology has not kept up with the growing demands of operators and steerable motors and tools currently in use have limitations. Many of these limitations are related to the current need to drill a portion of a well without drillstring rotation in order to make a sharp deviation. Drilling without rotation or "sliding" can cause numerous downhole problems and in some instances makes it impossible to drill extended reach or underbalanced wells.



During fiscal 1999, Tesco acquired from BP-Amoco the rights to an evolving technology called rotary steerable drilling. Rotary steerable directional tool technology allows well trajectory to be actively guided while rotating the drillstring, thereby overcoming many of the problems associated with existing deviated well technology. In addition, bit speed becomes a function of delivering high torque through string rotation rather than pumping mud through a low torque mud motor. This technology has been successfully applied in the field for short and medium radius horizontal wells to enhance production in older wells and reservoirs.

Tesco intends to further develop and enhance this technology at Gris Gun and couple it with state-of-the-art downhole monitoring equipment to achieve more efficient performance. Since rotary steering requires continuous drillstring rotation, it has considerable synergies with the Corporation's top drive business, will enhance its underbalanced drilling systems and has applications in Casing Drilling. The prototype rotary steerable tool is to be tested in June 1999. If testing is successful, commercial products could be available in the fall of 1999. Tesco has already been approached by large operators to apply its technology to specific drilling situations.



Management's Discussion and Analysis

The following is an historical review of Tesco's financial and operating results and should be read in conjunction with the consolidated financial statements of the Corporation for the years ended February 28, 1999 and February 28, 1998.

ANALYSIS OF OPERATIONS

Year Ended February 28, 1999

Total revenues decreased by 23% to \$126.1 million from \$163.7 million. Gross margin decreased by 41% to \$40.8 million from \$69.5 million.

Revenue from the Top Drive Division decreased by 25% to \$88.0 million as a result of a decrease in rental days to 13,576 from 19,547 and the sale of 18 top drive systems in the current fiscal year, compared to 27 in the previous year. The Corporation increased its top drive rental fleet to 111 systems at February 28, 1999 from 107 at February 28, 1998.

Sales by the Completions Division were \$14.3 million during the year ended February 28, 1999 compared to \$19.9 million in the preceding year. Management believes that the sales of this division are directly related to the number of oil and gas wells drilled in Western Canada which totaled approximately 9,700 in calendar year 1998 compared to 16,500 in 1997.

Third party revenues from the Electrical and the Hydraulics Divisions totalled \$15.2 million, a decrease of 34% from the previous year. In addition, these divisions supplied \$25.3

million of sales to other divisions which are excluded from consolidated revenue.

Direct costs of the Top Drive Division were down from \$62.7 million in fiscal 1998 to \$59.4 million in fiscal 1999 primarily due to the decrease in sales and rental activities and the related number of employees.

Activity in the Research, Engineering and Construction Division, based at the Corporation's Research and Development Centre, consisted principally of the testing and evaluation of the Casing Drilling project and construction services for two drilling rigs. Fiscal 1998 revenues included revenues from underbalanced drilling which were transferred to another division in March 1998. As a result, third party revenues declined from \$2.2 million in fiscal 1998 to \$0.2 million in fiscal 1999.

Overall gross margins decreased from 42% in fiscal 1998 to 32% in fiscal 1999. This decrease is attributable to increased pressure on pricing as a result of the slowdown in industry demand for the Corporation's products and services in fiscal 1999, as well as the decision by the Corporation to use the slowdown as an opportunity to carry out an extensive maintenance program on its top drive rental fleet.

Depreciation and amortization expense increased from \$7.9 million to \$10.5 million. The major capital expenditures during the year that account for this increase are the addition of five integrated underbalanced systems and the construction of the well-bore test centre at Gris Gun.

Selling and general and administration expenses were up by \$3.3 million and \$6.3 million respectively reflecting the increased cost of supporting the Corporation's efforts to broaden the range of its products and services and expand its international activities. Research and development expenses increased by \$2.5 million.

During fiscal 1999, the Corporation incurred restructuring charges of \$3.1 million as a result of actions taken to reduce the ongoing costs of its operating infrastructure. These costs which include severance payments resulting from reducing the size of the Corporation's workforce, costs incurred as a result of vacating leased premises prior to the expiry of the leases and reductions in the carrying amount of assets surplus to the Corporation's requirements, are expected to generate savings to the Corporation in the future and will not recur.

Financial income for the year decreased to \$1.0 million from \$1.3 million in the previous year. Interest expense increased from \$0.2 million in fiscal 1998 to \$1.6 million in the current year as a result of the Corporation drawing down its bank lines of credit during the year and the issuing of US\$46.5 million of Senior Notes. The interest expense for fiscal 1999 was offset by interest income of \$1.2 million earned principally on the investment of cash proceeds from the Senior Notes. Foreign exchange gains increased from \$0.1 million in fiscal 1998 to \$1.5 million in fiscal 1999 as a result of the reduction of the value of the Canadian dollar relative to the US dollar during the year.

Current tax expense was \$2.5 million compared with \$16.6 million in the previous year and future tax recovery was \$4.3 million compared to an expense of \$0.5 million in the previous year. The combined tax recovery was 40% of loss before taxes compared to a tax expense of 40.5% of income before tax in fiscal 1998. At February 28, 1999 the Corporation had tax pools totalling approximately \$117.1 million compared to \$61.2 million at February 28, 1998.

Additions to capital assets were \$42.6 million during the year compared to \$47.8 million during the preceding year. These additions included \$9.0 million spent on increasing the rental top drive fleet; \$23.2 million spent on constructing underbalanced drilling equipment and \$1.0 million to

complete construction of the new well-bore test centre for Gris Gun in Red Deer, Alberta.

On January 6, 1999, the Corporation issued US\$46.5 million of Senior Notes repayable on October 15, 2004. These Senior Notes are unsecured and bear interest at 7.59%, payable semi-annually. The net cash proceeds of this issue after commissions and offering costs were \$69.7 million, of which \$18.4 million was used to pay off existing bank debt. During fiscal 1999, the Corporation issued 527,250 common shares on the exercise of stock options for cash proceeds of \$3.3 million.

Year Ended February 28, 1998

Total revenues increased by 71% to \$163.7 million from \$95.7 million. Gross margin increased by 54% to \$69.5 million from \$45.0 million.

Revenue from the Top Drive Division increased by 62% to \$118.4 million as a result of an increase in rental days to 19,547 from 12,307 and the sale of 27 top drive systems in the fiscal year, compared to 14 in the previous year. The Corporation increased its top drive rental fleet to 107 systems at February 28, 1998 from 79 at February 28, 1997.

Sales by the Completions Division were \$19.9 million during the year ended February 28, 1998 compared to \$12.8 million in the preceding year. Management believes that the sales of this division are directly related to the number of oil and gas wells drilled in Western Canada which totalled approximately 16,500 in calendar year 1997 compared to 12,600 in 1996.

Third party revenues from the Electrical and the Hydraulics Divisions totalled \$23.1 million, an increase of 143% from the previous year, although the divisions were only included in the previous year for approximately nine to ten months. In addition, these divisions supplied \$21.7 million of sales to other divisions which are excluded from consolidated revenue.

Direct costs of Top Drive Division were up from \$34.7 million in fiscal 1997 to \$62.7 million in fiscal 1998 primarily due to

Financial Performance – Previous Twelve Quarters



the increase in sales and rental activities and the related number of employees.

The Corporation's Research and Development Centre in Calgary, which was established in May 1996, generated a significant percentage increase in activity for the Research, Engineering and Construction Division. Revenues for this division increased to \$2.2 million in the year from \$0.3 million in the previous year. The activity during the year included the continued development of the Casing Drilling project and the engineering design and construction of two innovative telescoping double drilling rigs, which were being built under a cost plus contract with a drilling contractor.

Overall gross margins decreased from 47% in fiscal 1997 to 42% in fiscal 1998 as a result of the increased percentage of sales contributed by the Hydraulic, Electrical and Completions Divisions, which are lower margin businesses than the Top Drive Division and an increase in the volume of after-sale support revenues in the Top Drive Division.

Depreciation and amortization expense increased from \$5.4 million to \$7.9 million due to the increase in the fleet of rental portable top drive systems, amortization of goodwill on acquisitions completed in fiscal 1997 and other capital asset additions.

Selling and general and administration expenses were up by \$1.9 million and \$5.3 million respectively reflecting increased sales activities and higher administrative support requirements. Research and development expenses increased by \$0.6 million.

Financial income for the year increased to \$1.3 million from \$0.8 million in the previous year. This increase was attributable primarily to an increase in interest income as a result of the investment of the net proceeds of the sale of 2,200,000 common shares in September, 1997. During the

year, the Corporation entered into a series of forward exchange contracts to fix the Canadian dollar value of a position of its U.S. dollar denominated cash flows; management estimates that had these contracts not been entered into, the Corporation would have reported additional foreign exchange gains of \$0.7 million.

Current tax expense was \$16.6 million compared with \$8.6 million in the previous year and future tax expense was \$0.5 million compared to \$2.6 million in the previous year. The combined tax provision was 40.5% of income before taxes compared to 40.6% in fiscal 1997. At February 28, 1998, the Corporation had tax pools totalling approximately \$61.2 million compared to \$46.0 million at February 28, 1997. The Corporation changed its accounting policy with respect to deferred tax from the deferral method to the liability method. This resulted in a prior period adjustment of \$0.1 million at February 28, 1998. In addition the group's tax provision was increased by \$0.2 million resulting from an increase in the historical rate of accumulation of future tax timing differences to the fiscal 1998 average rate.

Additions to capital assets were \$47.8 million during the year compared to \$28.6 million during the preceding year.





These additions included \$18.6 million spent on increasing the rental top drive fleet; \$9.6 million spent on constructing underbalanced drilling equipment and \$2.6 million to complete construction of the new operations facility in Houston, Texas. Also during the year, \$12.1 million was added to technology and development costs as a result of the February, 1998 acquisition of all of the units of the Casing Drilling Joint Venture for 418,036 common shares.

On September 22, 1997, the Corporation issued 2,200,000 common shares at \$23.00 each. The net cash proceeds of this issue after commissions and offering costs were \$48.3 million. Other share capital issues with respect to share purchase options and warrants totalled \$9.1 million.

LIQUIDITY AND CAPITAL POSITION

At February 28, 1999, the Corporation's working capital position was \$103.0 million compared to \$84.5 million at February 28, 1998. The increase is principally attributable to an increase in cash on hand arising from the receipt of the proceeds of the Senior Note issue in January, 1999 and a decrease in accounts payable and accrued liabilities that reflects a reduction in purchasing as the volume of business has declined. The amount of the Corporation's inventory has increased by \$12.5 million at February 28, 1999 from February 28, 1998. However, the Corporation has assessed \$12.2 million of the inventory on hand at February 28, 1999 to be in excess of requirements for the next fiscal year and has therefore excluded this inventory from working capital.

The Corporation's long term debt consists solely of the Senior Notes repayable on October 15, 2004. In addition to this debt, the Corporation has available to it an unsecured bank credit facility consisting of an operating line of \$15.0 million. Management believes that its banking arrangements together with the funds on hand and generated from operations will be sufficient to meet the Corporation's capital needs for the 2000 fiscal year.

FUTURE OUTLOOK

The Corporation expects a gradual improvement in the level of industry activity as calendar 1999 progresses. Consequently, the focus for the immediate future will be to maintain a cost structure commensurate with the level of business and to improve the drilling industry's awareness and understanding of the Corporation's products and services. The Corporation expects that the measures taken in the final quarter of fiscal 1999 to restructure the organization and reduce future costs, combined with an improving environment, will allow a return to profitability in fiscal 2000.

Drilling Services

The organization of drilling services into regional business units will enhance the ability of the Corporation to combine and cross-sell its top drive, underbalanced and other drilling services to the industry. Industry interest in the combination of services offered by Tesco is high; however, the projects tend to be of a greater size and complexity than those previously undertaken by Tesco which leads management to believe that the revenue benefits from this work will not be apparent until the latter part of fiscal 2000.

Top drive rentals and sales will continue to be a core activity for the Corporation. No new top drives will be added to the existing rental fleet unless there is a specific requirement. Tesco's integrated underbalanced systems were successfully introduced in Canada during fiscal 1999. It is expected that an

increasing volume of underbalanced drilling work will be obtained in the international market in fiscal 2000. Further systems will be added by Tesco as demand warrants.

The Corporation expects there will be an ongoing development in the range of drilling products and services delivered by Tesco during fiscal 2000 that will make a positive contribution to future revenues. The principal contributors are expected to be Casing Drilling and rotary steerable drilling tools.

Product Development

It is expected that product development activities for fiscal 2000 will concentrate on the commercialization of Casing Drilling and the continuing development of related technologies.

Well Completions

The acquisition of the business and assets of Dynamic Oil Tools on March 1, 1999 will provide Gris Gun with the opportunity to increase sales volume in Canada despite the expectation of no significant change in the level of well completions in western Canada for fiscal 2000. Gris Gun also anticipates a continuing growth in the volume of business obtained in the United States and internationally.

Gris Gun expects to be able to contribute substantially to the Corporation's product development efforts in the area of rotary steerable and Casing Drilling tools through its downhole tool engineering and design expertise and the use of its well testing facility.

Industrial Group

The emphasis for the industrial group, consisting of Mainline Industries, Kelon Electric and Ener-Rig Supply, will be to build up their base of third party business. During this phase of refocusing on external rather than internal business opportunities, it is not expected that this group will make a significant contribution to the Corporation's profits.

Year 2000 Computer Issues

The Corporation has established a working group under the direction of the Manager of Information Systems to develop and implement a plan to minimize the Corporation's risk arising from the failure of its or its business partners' computer systems to adapt to the Year 2000 without error. This group was established in early fiscal 1999 and has generated quarterly progress reports to the Board of Directors.

To date, no significant risk has been identified in systems employed by the Corporation, its services or products. The working group has identified and is maintaining open communications with key business partners with respect to Year 2000 matters and is encouraged by the degree of awareness and commitment shown to date. Since the Corporation's activities are worldwide there are instances where the Corporation could be exposed to banking system failures and other problems. The Corporation plans to reduce financial asset holdings to low levels in countries where systemic failures are more likely to occur.

The Corporation has not identified any material financial cost, either current or future, for modifying computer systems that may not be Year 2000 compliant. While the Corporation is taking reasonable steps to minimize the risks associated with Year 2000 issues, it is likely that some risk will remain.



Business Risks

The Corporation's business is primarily to provide services to the oil and gas exploration industry throughout the world. The level of activity of this industry and hence its capacity to purchase services such as those offered by the Corporation tends to fluctuate depending on the outlook for the prices of oil and gas. The Corporation also competes with many other companies to provide its services. The Corporation believes that its services are both technically and economically competitive, but many of its competitors are more established in the regions of the world in which the Corporation operates and have more substantial financial

resources. Although the Corporation's operating currency is Canadian dollars, much of its business is conducted in US dollars and other foreign currencies. As such, the Corporation is exposed to financial gains and losses arising from changes in the rate of exchange between the Canadian dollar and these other currencies.

Management is aware of these risks and adopts product development, marketing and financial management strategies to minimize the potential negative impacts of adverse changes in the business environment. However, there can be no assurance that management will accurately foresee changes or that the strategies adopted will be successful.



Management's Report

Management is responsible for the preparation of the consolidated financial statements and the information contained in this annual report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles using appropriate accounting policies, methods and estimates as selected by management giving consideration to the Corporation's circumstances. The financial and operating information included in this annual report is consistent, in all material respects, with that contained in the consolidated financial statements.

The Corporation maintains systems of accounting and internal controls to provide reasonable assurance that its financial information is reliable, relevant and accurate, and that its assets are adequately safeguarded.

The Audit Committee, consisting of three non-executive directors, is responsible for reviewing the consolidated financial statements and other financial information contained in this annual report and overseeing management's performance of its financial reporting responsibilities. The Audit Committee has reviewed these financial statements with management and the auditors. The external auditors have unlimited access to the Audit Committee, are appointed by the Shareholders, and have independently examined the consolidated financial statements on the recommendation of the Audit Committee.



ROBERT M. TESSARI
President and Chief Executive Officer



MARTIN HALL
Senior Vice-President, Finance and Secretary

Auditors' Report

To: The Shareholders of Tesco Corporation

We have audited the consolidated balance sheets of Tesco Corporation as at February 28, 1999 and 1998 and the consolidated statements of earnings, retained earnings and changes in financial position for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements presently fairly, in all material respects, the financial position of the Corporation as at February 28, 1999 and 1998 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.



PricewaterhouseCoopers
Chartered Accountants

CALGARY, ALBERTA
May 14, 1999

CONSOLIDATED BALANCE SHEETS

	NOTES	1999 \$	1998 \$
As at February 28			
(Thousands of Canadian Dollars)			
ASSETS			
Current assets			
Cash and short term deposits		47,094	28,179
Accounts receivable		30,441	56,102
Income taxes recoverable	7	6,307	—
Inventories	4	33,431	33,158
		117,273	117,439
Capital assets	5	131,658	99,036
Goodwill and other assets	6	19,398	4,020
		268,329	220,495
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		14,323	31,695
Income taxes payable	7	—	1,226
		14,323	32,921
Long term debt	8	69,665	—
Future income taxes	7	4,883	8,772
		88,871	41,693
SHAREHOLDERS' EQUITY			
Share capital	9	127,215	123,930
Retained earnings		52,243	54,872
		179,458	178,802
		268,329	220,495

Signed on behalf of the Board of Directors



ROBERT M. TESSARI
Director



WILLIAM S. RICE
Director

CONSOLIDATED STATEMENTS OF EARNINGS

	NOTES	1999 \$	1998 \$
For the years ended February 28			
(Thousands of Canadian Dollars except for per share amounts)			
Sales		126,074	163,659
Cost of sales		85,226	94,201
Gross profit		40,848	69,458
EXPENSES			
Depreciation and amortization		10,520	7,893
General and administration		18,602	12,330
Selling		9,995	6,715
Research and development		3,974	1,505
Restructuring charges	10	3,117	—
Financial (income) expense	11	(978)	(1,276)
		45,230	27,167
Earnings (loss) before income taxes		(4,382)	42,291
Income tax expense (recovery):			
current	7	2,500	16,624
future	7	(4,253)	513
		(1,753)	17,137
Net earnings (loss) for the year		(2,629)	25,154
Net earnings (loss) per share:			
basic		(0.08)	0.87
fully-diluted		(0.08)	0.82

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

For the years ended February 28			
(Thousands of Canadian Dollars)			
Retained earnings – beginning of the year			
as previously reported		54,872	29,856
effect of change in accounting policy	2	—	(138)
as restated		54,872	29,718
Net earnings (loss) for the year		(2,629)	25,154
Retained earnings – end of the year		52,243	54,872

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	NOTES	1999 \$	1998 \$
For the years ended February 28			
(Thousands of Canadian Dollars)			
OPERATING ACTIVITIES			
Net earnings (loss) for the year		(2,629)	25,154
Adjusted for items not involving funds –			
Future income taxes		(4,253)	513
Depreciation and amortization		10,520	7,893
Write down of assets included in restructuring charges		535	—
Amortization of financial items		15	—
		4,188	33,560
Changes in non-cash working capital balances		483	(32,523)
		4,671	1,037
INVESTING ACTIVITIES			
Business acquisitions	14	—	617
Additions to capital assets		(42,625)	(35,701)
Goodwill and other assets (net)		(16,430)	(186)
		(59,055)	(35,270)
FINANCING ACTIVITIES			
Net proceeds from long term debt		69,650	—
Issue of share capital		3,285	59,681
Share issue costs, net of current tax benefit		364	(1,866)
		73,299	57,815
Net increase in cash position during year		18,915	23,582
Net cash and short term deposits – beginning of year		28,179	4,597
Net cash and short term deposits – end of year		47,094	28,179

Non-cash working capital consists of accounts receivable, income taxes recoverable and inventories less accounts payable and accrued liabilities and income taxes payable.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended February 28, 1999 and 1998

(Thousands of Canadian Dollars)

1. Accounting Policies

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. The preparation of these financial statements requires management to make estimates as to the eventual financial consequences of many of the transactions and business activities of the Corporation. The most significant of these estimates are: the Canadian dollar amount at which transactions denominated in foreign currencies will be settled; the amount at which accounts receivable and inventories will be realized; and the rate at which the cost of capital assets and goodwill should be matched against revenues earned in a period. Management makes these estimates based on its judgement of the likely outcome of future events; as such there is a significant risk that the actual outcome will be different than expected and that such differences will have a material financial effect on future reported results.

Significant specific accounting policies applied by the Corporation are:

(a) CONSOLIDATION

The consolidated financial statements include the accounts of the Corporation and its domestic and foreign subsidiaries, all of which are wholly-owned.

(b) FOREIGN CURRENCY TRANSLATION

The Corporation's foreign operations are considered to be fully integrated and all amounts in foreign currencies have been translated to Canadian dollars on the following basis:

- (i) monetary assets and liabilities, at the exchange rate prevailing at year end;
- (ii) non-monetary assets and liabilities at historic rates of exchange;
- (iii) revenues and expenses (excluding depreciation and amortization which are translated at the same rate as the related assets), at the average rate of exchange for the period.

Resulting foreign exchange translation gains and losses, including those arising from other transactions denominated in foreign currencies, are included in the statement of earnings, except that the exchange gain or loss arising on the Corporation's long term debt denominated in U.S. dollars is deferred and amortized over the life of the debt.

c. INVENTORIES

Inventories are valued at the lower of cost and net realizable value. Cost of raw materials and finished goods is calculated on an average-cost basis. Work in progress includes raw materials, direct labour and applicable factory overhead. Inventories that are held for use beyond the end of the Corporation's one year business cycle are classified with other assets.

d. CAPITAL ASSETS

The Corporation's fleet of rental top-drive and underbalanced systems is included as drilling equipment in capital assets. The sale of rental systems results in the net book value of such systems being expensed as a cost of sale.

e. **DEPRECIATION AND AMORTIZATION**

Depreciation and amortization are provided for on the straight-line method based on the estimated useful lives of the various major classes of assets as follows:

	estimated useful life in years
Buildings	20
Drilling equipment	10 - 12
Manufacturing equipment	5
Technology and development costs	12

Office furniture and equipment and small tools are depreciated on the declining-balance method at rates ranging from 20-30%. Certain other capital assets are depreciated on the straight-line basis at rates varying between one and ten years. The estimated residual value of these assets is immaterial.

f. **GOODWILL**

Goodwill represents the excess of the cost of the purchase of various businesses over the net book value of their underlying net assets at the date of acquisition and is being amortized on a straight-line basis over five to ten years.

Operations of the businesses to which the goodwill relates are assessed annually to determine the appropriateness of the carrying value of the goodwill.

g. **RESEARCH AND DEVELOPMENT**

The Corporation expenses research costs. Costs of product development for specific applications, which in the opinion of management are marketable, are capitalized as technology and amortized over the expected useful life of the asset. Product development costs that are capitalized are assessed

periodically to determine if the carrying value is still appropriate.

h. **PER SHARE INFORMATION**

Per share information is computed using the weighted average number of common shares outstanding during the year. Fully-diluted per share information is computed assuming that all options and warrants are exercised at their date of issue and the proceeds invested to generate earnings at an after tax yield equal to the expected income on investment of the proceeds. No adjustment to basic earnings per share is made if the result of this calculation is anti-dilutive.

2. Change in Accounting Policy

The Corporation adopted a change in its method of accounting for income taxes in the year ended February 28, 1998. Previously, the Corporation had provided deferred taxes based on differences between reported income before tax and taxable income in a period arising as a result of items being included in reported income and taxable income in different periods; such deferred taxes were computed at tax rates in effect when the timing difference arose and were not subsequently adjusted for changes in tax rates. The Corporation now provides future taxes on differences between the reported amounts of assets and liabilities on the balance sheet and their values for tax purposes; these differences are measured at the end of each reporting period and future taxes are computed at current tax rates. To the extent differences arise as a result of tax loss carry forwards, the Corporation now recognizes the benefit of these losses when it is more likely than not that they will be used to reduce future taxes payable, rather than recognizing the benefit when it was realized as was previously the case. This change has been applied retroactively, resulting in changes to previously

reported income tax liabilities and expense and retained earnings.

The cumulative effect on retained earnings at March 1, 1997 was \$138.

3. Financial Instruments

With the exception of long term debt (see note 8), the Corporation's financial instruments are substantially all cash and trade receivables and payables, the book value of which approximates their fair value. The Corporation's accounts receivable are principally with major international and state oil and gas service and exploration and production companies and are subject to normal industry credit risks.

A substantial portion of the Corporation's revenues and expenses are denominated in US dollars; the Corporation's management monitors the expected net cash flows of U.S. dollars and places appropriate currency hedges with major financial institutions when warranted. At February 28, 1999, the Corporation had no commitments to sell or purchase U.S. dollars in future periods. During the year ended February 28, 1999, the Corporation sold a total of US\$2,200 in March, 1998 at a rate of Cdn\$1.3602 pursuant to forward exchange contracts; the Corporation's average spot exchange rate for that month was Cdn\$1.4236. During the year ended February 28, 1998, the Corporation sold a total of US\$8,800 at an average rate of Cdn\$1.3494 pursuant to forward exchange contracts; the Corporation's average spot exchange rate for the year ended February 28, 1998 was Cdn\$1.40.

The Corporation has negotiated an unsecured credit facility with its bankers that provides a maximum loan, repayable on demand, of \$15,000. Interest on amounts drawn under the facility is at the bank's prime rate. At February 28, 1999, no amounts were drawn under the facility.

4. Inventories

	1999	1998
Raw materials	\$ 13,264	\$ 19,961
Work in progress	1,438	3,346
Finished goods	18,729	9,851
	\$ 33,431	\$ 33,158

5. Capital Assets

	Cost	Accumulated Depreciation and Amortization	Net Book Value
At February 28, 1999			
Land, buildings and leaseholds	\$ 8,473	\$ 814	\$ 7,659
Drilling equipment	106,117	17,385	88,732
Work in progress	14,286	—	14,286
Manufacturing equipment	5,573	2,755	2,818
Technology and development costs	14,777	1,253	13,524
Office and other	6,356	1,717	4,639
	\$ 155,582	\$ 23,924	\$ 131,658
At February 28, 1998			
Land, buildings and leaseholds	\$ 6,401	\$ 558	\$ 5,843
Drilling equipment	80,344	9,750	70,594
Work in progress	3,248	—	3,248
Manufacturing equipment	4,646	1,369	3,277
Technology and development costs	14,527	1,001	13,526
Office and other	4,095	1,547	2,548
	\$ 113,261	\$ 14,225	\$ 99,036

Drilling equipment includes related manufacturing costs and overhead. Work in progress relating to drilling equipment under construction is not depreciated. The net book value of drilling equipment included in cost of sales for the year is \$7,115 (1998 - \$7,976).

6. Goodwill and Other Assets

	1999	1998
Goodwill	\$ 4,304	\$ 4,937
Accumulated amortization	(1,667)	(1,248)
	2,637	3,689
Inventory	12,217	—
Investment	4,500	—
Other	44	331
	\$ 19,398	\$ 4,020

Inventory is comprised of parts that the Corporation does not expect to use within the normal business cycle of one year. The investment comprises an equity investment in a privately-held drilling contractor based in western Canada, which is accounted for at cost.

7. Income Taxes

Income tax expense (recovery), which is 40% of income (loss) before income tax (1998 - 40.5%), varies from the amounts that would be computed by applying the combined federal and Alberta provincial income tax rate of 44.6% (1998 - 44.6%) due to the following factors:

	1999	1998
Income (loss) before income taxes	\$ (4,382)	\$ 42,291
Expected income tax expense (recovery)	(1,954)	18,862
Reduction of expected income tax expense (recovery) as a result of:		
Tax rates applied to earnings not attributed to Alberta	221	1,109
Reduced tax rate on manufacturing operations	(20)	616
Income tax expense (recovery) for the year	\$ (1,753)	\$ 17,137

Future income taxes arise principally as a result of the tax value of the Corporation's capital assets being lower than their net book value. The amount remaining to be claimed for tax purposes in respect of expenditures on capital assets at February 28, 1999 is \$117,054.

No provision is made for taxes that may be payable on the repatriation of accumulated earnings in foreign subsidiaries on the basis that these earnings will continue to be used to finance the activities of these subsidiaries.

9. Share Capital

a. AUTHORIZED

- Unlimited common shares without par value
- Unlimited first preferred shares issuable in series
- Unlimited second preferred shares issuable in series

b. ISSUED COMMON SHARES

	Number of shares	Amount
Balance – February 28, 1997	27,330,857	\$ 57,326
Issued for cash pursuant to prospectus	2,200,000	50,600
Issued for cash on exercise of stock options	477,206	3,445
Issued for cash on exercise of share purchase warrants	943,351	5,636
Issued in exchange for Casing Drilling Joint Venture interests (note 14)	418,036	8,131
Share issue costs (net of future tax benefits of \$ 1,064)		(1,208)
Balance – February 28, 1998	31,369,450	\$ 123,930
Issued for cash on exercise of stock options	527,250	3,285
Balance – February 28, 1999	31,896,700	\$ 127,215

8. Long Term Debt

Long term debt consists of US\$46,500 unsecured Senior Notes due on October 15, 2004. These notes bear interest at 7.59% payable semi-annually. Costs, principally commission and legal fees, incurred in obtaining this financing are deferred and amortized over the term of the debt. Exchange gains and losses arising from converting the principal amount of the debt from U.S. to Canadian dollars at period end exchange rates are deferred and amortized over the remaining term of the debt.

Debt principal (US\$46,500)	\$ 70,150
Deferred foreign exchange gain	78
Deferred financing costs	(563)
	\$ 69,665

Cumulative amortization of foreign exchange gains (losses) and deferred financing costs at February 28, 1999 are \$1 and \$16 respectively, of which \$1 and \$16 are included in foreign exchange gain and interest expense for the year.

The fair value of the Corporation's long term debt depends primarily on current market interest rates for debt issued with similar maturities by companies with risk profiles similar to the Corporation's. In management's opinion, the fair value of the Senior Notes at February 28, 1999 is not materially different from their book value.

c. STOCK OPTIONS

Stock options to purchase 2,877,450 common shares have been granted to the directors, senior officers and key employees and are outstanding. These options range in price from \$2.05 to \$25.75 and expire on various dates to January 31, 2004. The gross proceeds to the Corporation if all these options were exercised would be \$35,739.

10. Restructuring Charges

In response to the precipitous decline in oil and gas drilling activity in late 1998, management instituted a plan of action to reduce the level of resources employed by the Corporation. Specific actions included: a reduction in payroll costs as a result of layoffs, reduced pay rates and benefit reductions; a reduction of lease and other premises costs as a result of consolidating space requirements; and a reduction of inventory levels necessary to sustain ongoing activities. These actions required the Corporation to incur substantial expenses, including severance payments, lease cancellation costs and write-downs of inventory values, that are not expected to recur. These costs are reflected in these consolidated financial statements as restructuring charges.

11. Financial (Income) Expense

Items comprising net financial income are:

	1999	1998
Interest income	\$ (1,158)	\$ (1,342)
Interest expense	1,563	155
Foreign exchange (gain) loss	(1,516)	(103)
Other financial charges (gains)	133	14
	\$ (978)	\$ (1,276)

Interest expense includes \$889 (1998: nil) in respect of debt initially incurred for a period exceeding one year.

12. Commitments and Contingencies

The Corporation has non-cancelable lease commitments for its manufacturing and operations facilities as follows:

Years ending February 28	\$
2000	905
2001	704
2002	504
2003	305
2004	11
Thereafter	—

13. Segment Information

The Corporation has six operating divisions which provide different products and services to the Corporation's customers. The Corporation's operations are principally in the oil and gas service sector. Each division has its own management and reports separately to the Corporation's executive. The operating divisions are:

- **Top drive division** – manufactures, rents and sells proprietary top drive equipment to drilling contractors and oil and gas operators;
- **Reservoir drilling services division** – builds and operates underbalanced drilling systems and related products and services.
- **Hydraulic division** – provides a wide range of hydraulic systems and services to customers, including other operating divisions of the Corporation;
- **Electrical division** – provides a wide range of electrical systems and services to customers, including other operating divisions of the Corporation;
- **Completions division** – designs, manufactures and sells down hole completion devices for the oil and gas industry;
- **Research, engineering and construction division** – researches and develops innovative drilling equipment for commercial exploitation by the Corporation and for third parties.

Operating divisions report their results of operations to the level of earnings before income taxes. Income taxes, together with interest and other revenues and management and administrative costs of the corporate office, are not allocated to operating divisions.

Year ended February 28, 1999

	Revenues		Depreciation and amortization	Earnings before taxes	Assets employed	Capital expenditures
	Internal	Third party				
Top drive	\$ 204	\$ 87,967	\$ 7,170	\$ 8,793	\$ 136,725	\$ 10,673
Hydraulic	6,028	4,822	421	(513)	7,949	266
Electrical	19,287	10,376	407	(1,818)	6,693	407
Completions	297	14,264	843	432	14,662	2,818
Reservoir drilling services	63	8,446	1,427	(3,288)	39,642	25,793
Research, engineering and construction	431	199	372	(4,143)	19,326	2,849
	\$ 26,310	\$ 126,074	\$ 10,640	\$ (537)	\$ 224,997	\$ 42,806
Intersegment eliminations			(168)	10	(1,967)	(679)
Corporate items			48	(3,855)	45,299	498
			\$ 10,520	\$ (4,382)	\$ 268,329	\$ 42,625

Year ended February 28, 1998

	Revenues		Depreciation and amortization	Earnings before taxes	Assets employed	Capital expenditures
	Internal	Third party				
Top drive	—	\$ 118,435	\$ 6,304	\$ 39,715	\$ 132,273	\$ 23,023
Hydraulic	7,897	7,173	335	1,813	7,464	252
Electrical	13,845	15,973	296	1,102	14,071	548
Completions	92	19,910	719	4,374	13,939	992
Research, engineering and construction	—	2,168	152	(835)	24,795	10,205
	\$ 21,834	\$ 163,659	\$ 7,806	\$ 46,169	\$ 192,542	\$ 35,020
Intersegment eliminations			(54)	(1,366)	(2,018)	(845)
Corporate items			141	(2,512)	29,971	1,526
			\$ 7,893	\$ 42,291	\$ 220,495	\$ 35,701

The Corporation generated sales and owned capital assets and goodwill in the following areas of the world:

	Sales	Capital assets and goodwill
Year to February 28, 1999		
Canada	\$ 41,151	\$ 81,880
United States	36,883	21,391
Latin America	31,026	19,741
Southeast Asia	6,548	4,152
Other countries	10,466	7,131
Year to February 28, 1998		
Canada	\$ 56,974	\$ 66,560
United States	50,679	15,748
Latin America	25,172	14,707
Southeast Asia	15,760	2,587
Other countries	15,074	3,123

14. Acquisition

During the year ended February 28, 1998, the Corporation acquired the business and net assets of the Casing Drilling Joint Venture as a result of an offer to purchase all of the units of the Joint Venture not already owned by the Corporation. Consideration for the purchase consisted of 418,036 common shares of the Corporation. The Casing Drilling Joint Venture is developing equipment and technology to permit the drilling of oil and gas wells with casing. The activities of the Joint Venture are based at the Corporation's Research and Development Centre in Calgary. Prior to the acquisition, which occurred in February, 1998 and is accounted for using the purchase method, the Corporation held an investment of less than 5% of the units of the Joint Venture which was acquired at a cash cost of \$101. This investment was included at cost in other assets.

Net assets acquired and consideration given up to acquire this Joint Venture were:

	1998
Net assets acquired:	
Working capital	\$ 718
Capital assets	12,085
	12,803
Future taxes	4,571
	8,232
Consideration:	
Cash	101
Common shares	8,131
	\$ 8,232

15. Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect the Corporation's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Corporation, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

16. Reconciliation to United States Generally Accepted Accounting Principles

The consolidated financial statements of the Corporation are prepared using accounting principles that are generally accepted in Canada. These principles differ in some material respects from those that are generally accepted in the United States. For the years ended February 28, 1999 and 1998, the principal differences that result in material measurement changes in the consolidated financial statements of the Corporation are:

a. ACCOUNTING FOR RESEARCH AND DEVELOPMENT COSTS

Costs of product development that are capitalized as technology and amortized under Canadian GAAP are required to be expensed in the period incurred under U.S. GAAP. Included in the expense for the year ended February 28, 1998 is the cost, net of future taxes, attributed to technology and development costs arising from the acquisition of the Casing Drilling Joint Venture; for U.S. GAAP purposes, this cost includes the valuation attributed to the warrants issued to Casing Drilling subscribers (see note 16(c)).

b. FOREIGN EXCHANGE GAINS AND LOSSES

Under Canadian GAAP, foreign exchange gains and losses arising on the conversion of non-current monetary liabilities with fixed maturity dates are deferred and amortized over the remaining term to maturity of the debt. U.S. GAAP requires the full amount of such gains and losses to be accounted for in the determination of net earnings or loss for the period in which they arise.

c. VALUATION OF OPTIONS AND WARRANTS

U.S. GAAP requires that options and warrants issued for other than compensation purposes

be accounted for at their fair value at the date granted. In December, 1995, the Corporation granted 980,000 options and warrants in conjunction with the formation of the Casing Drilling Joint Venture. These options and warrants had a fair value at their grant date of approximately \$3,675, which amount would be added to the Corporation's investment in and subsequent acquisition of the Casing Drilling Joint Venture and to share capital for U.S. GAAP purposes.

d. REDUCTION OF CAPITAL

In November 1993, the Corporation reduced its share capital by \$13,842 to eliminate its accumulated deficit. U.S. GAAP requires that the financial statements continue to reflect this accumulated deficit by restating share capital on the basis that the reduction had not occurred.

e. COMPUTATION OF EARNINGS PER SHARE

Canadian GAAP requires the computation and presentation of basic and fully diluted earnings per share, whereas U.S. GAAP requires the computation of basic and diluted earnings per share. The respective calculations of fully-diluted earnings per share under Canadian GAAP and diluted earnings per share under U.S. GAAP differ principally in that, under Canadian GAAP, the dilutive effect of contingent common share issues is calculated by assuming a rate of return on the notional proceeds from contingent issues, whereas under U.S. GAAP, the treasury stock method is used.

The effect of these differences on the reported results and financial position of the Corporation is as follows:

CONSOLIDATED STATEMENTS OF EARNINGS

	1999	1998
Net earnings (loss) – Canadian GAAP	\$ (2,629)	\$ 25,154
Adjusted for:		
Research and development costs	1	(11,107)
Deferred foreign exchange losses (gains)	47	—
Net earnings (loss) – U.S. GAAP	(2,581)	14,047
Net earnings (loss) (in accordance with U.S. GAAP) per common share:		
U.S. GAAP – diluted	\$ (0.08)	\$ 0.47

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

	1999	1998
Retained earnings, beginning of year – Canadian GAAP	\$ 54,872	\$ 29,718
Adjusted for:		
Cumulative effect of research and development costs	(12,087)	(980)
Reduction of share capital	(13,842)	(13,842)
	28,943	14,896
Net earnings (loss) for the year – U.S. GAAP	(2,581)	14,047
Retained earnings, end of year – U.S. GAAP	\$ 26,362	\$ 28,943

CONSOLIDATED BALANCE SHEETS

	1999	1998
Capital assets – Canadian GAAP	\$ 131,658	\$ 99,036
Adjusted for:		
Research and development costs	(13,524)	(13,526)
U.S. GAAP	\$ 118,134	\$ 85,510
Long term debt – Canadian GAAP	\$ 69,665	—
Adjusted for:		
Deferred foreign exchange losses (gains)	(78)	—
U.S. GAAP	\$ 69,587	\$ —
Future income taxes – Canadian GAAP	\$ 4,883	\$ 8,772
Adjusted for:		
Research and development costs	(5,149)	(5,150)
Deferred foreign exchange (losses) gains	31	—
U.S. GAAP	\$ (235)	\$ 3,622
Share capital – Canadian GAAP	\$ 127,215	\$ 123,930
Adjusted for:		
Valuation of options and warrants	3,675	3,675
Reduction of capital	13,842	13,842
U.S. GAAP	\$ 144,732	\$ 141,447

Corporate Information

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Fred J. Dymont 1,2,3
President and Chief Executive Officer,
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Calgary, AB

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Independent Businessman,
Dallas, TX

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Chairman of the Board,
Partner, Bennett Jones
Calgary, AB

Norman W. Robertson 1,2,3
Independent Businessman,
Calgary, AB

Robert M. Tessari
President and Chief Executive Officer,
Tesco Corporation
Calgary, AB

1 Audit Committee

2 Compensation Committee

3 Corporate Governance Committee

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Executive Vice President and
Chief Operating Officer,
Tesco Corporation

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Alaska	Netherlands
Algeria	Nigeria
Argentina	Oman
Australia	Pakistan
Austria	Peru
Bangladesh	Philippines
Bolivia	Russia
Brazil	Saudi Arabia
Canada	South Africa
China	Spain
Columbia	Tunisia
Ecuador	Turkey
India	U.A.E.
Indonesia	United Kingdom
Italy	United States
Japan	Venezuela
Mexico	Yemen

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